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John M. Lacey is Ernst & Young Research Fellow and Professor of Accounting at California State University - Long Beach. He previously taught at the School of Accounting at the University of Southern California (USC) and at Anderson Graduate School of Management at UCLA. He earned his Ph.D. at UCLA with a major in accounting information systems and minors in economics and mathematics and earned his MBA and BS degrees from USC.

Professor Lacey is a CPA. He has served on the Accounting Standards Executive Committee (AcSEC) and chaired AcSEC's International Accounting Standards Task Force and its Participating Mortgages Task Force. He also served as Chairman of the AICPA Real Estate Committee and chaired its Accounting and Auditing Guide Task Force and has chaired the AICPA National Real Estate Conference. He is a was a member of the AICPA Continuing Professional Education task force and a Member of the Board of Directors of the California Society of CPAs and Chair of its Accounting Principles and Auditing Standards Committee. Professor Lacey is a member of a task force of the Independence Standards Board.

Professor Lacey regularly conducts accounting training programs for judges on behalf of the AICPA Judiciary Committee and the National Judicial College and Federal Judicial Center. He conducts training programs and technical updates for The Capital Group, Union Bank of California, and Wells Fargo Bank. He also presents continuing education programs for members of the Los Angeles Society of Financial Analysts and conducts the Level I and Level II accounting reviews for their CFA Review Program. He is a consultant and speaker to various business, governmental, and not-for-profit organizations.

Professor Lacey is the author of a research study on auditor independence commissioned by the Chief Accountant of the Securities & Exchange Commission. He has published books and monographs, and articles in academic and professional journals, including an academic paper, which is one of the 25 most, cited accounting studies in the last 30 years. Professor Lacey also serves as an expert witness in major legal cases involving accounting and financial issues. Prior to his academic career, Professor Lacey was a supervisor in the national office of a major CPA firm and served as corporate officer and controller of a manufacturing company.

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PRINCIPAL ACADEMIC POSITIONS

ERNST & YOUNG RESEARCH FELLOW & PROFESSOR OF ACCOUNTANCY, (1989 - Present), School of Business, California State University, Long Beach

VISITING ASSISTANT PROFESSOR, (1988 - 1989) Anderson Graduate School of Management, University of California, Los Angeles

ASSISTANT PROFESSOR OF ACCOUNTING, (1981 - 1987) School of Accounting, University of Southern California, Los Angeles

EDUCATION & CERTIFICATION

1982 UNIVERSITY OF CALIFORNIA, LOS ANGELES
Ph.D. in Management
Major - Accounting and Information Systems
Minors - Economics and Mathematics
Additional course-work in finance.

1975-76 STANFORD UNIVERSITY
Enrolled in Ph.D. program in accounting.
Transferred to UCLA.

1975 CPA CERTIFICATION STATE OF CALIFORNIA

1973 UNIVERSITY OF SOUTHERN CALIFORNIA
MBA
Major - Quantitative Business Analysis

1972 UNIVERSITY OF SOUTHERN CALIFORNIA
BS, Business
Major - Accounting

PROFESSIONAL EXPERIENCE

CHAIR, (1993 - 1996), MEMBER, (1986 - 1989), Real Estate Committee of the American Institute of Certified Public Accountants (AICPA). Fifteen-member technical committee, which proposes, drafts, and presents accounting standards on real estate issues.

MEMBER, (1990 - 1993) Accounting Standards Executive Committee (AcSEC) of the AICPA. AcSEC is the senior AICPA technical committee whose 15 members vote to issue Statements of Position and Accounting Guides, that establish new or modify existing generally accepted accounting principles for all public and private companies.

CHAIR, (1993 - Present) Real Estate Accounting & Auditing Guide Task Force of Real Estate Committee, AICPA.

CHAIR (1987 - 1997) Participating Mortgages Subcommittee of AcSEC, AICPA.

MEMBER, (1991 - 1996), CHAIR, (1991 - 1993) International Accounting Standards task force of AcSEC. Chair and member of task force that drafts the official response of the AICPA to proposed standards of the International Accounting Standards Committee. Member of task force to draft response to proposed Investments standard in 1999.

CHAIR, (1997, 1998, 1999) First, Second, and Third Annual AICPA Real Estate Conference, New Orleans, LA., Beverly Hills, CA., and Orlando, FL.

MEMBER, (1996 - 2000), AICPA Continuing Professional Education Standards Task Force.

CHAIR (1999- Present), MEMBER, (1990 - 1999), Accounting Principles and Auditing Standards Committee of the California State Society of Certified Public Accountants. Committee that represents the Certified Public Accountants of California in responding to proposed accounting and auditing standards. AcSEC liaison 1990 - 1993, International Accounting and Auditing Subcommittee Chair, 1992 - Present.

MEMBER, (1999 - Present), Board of Directors of the California State Society of Certified Public Accountants.

MEMBER, (1999 – Present) Evolving Forms of Firm Structures and Organization Task Force, Independence Standards Board.

SUPERVISOR IN NATIONAL ACCOUNTING AND AUDITING DEPARTMENT, (1973 - 1975 Laventhol & Horwath Executive Office (Philadelphia and Los Angeles). Researched complex accounting problems, which could not be resolved at local or regional levels. Planned and conducted audits of clients. Managed the revision of the firm's statistical auditing approach. Helped to establish and communicate the firm's position on accounting and auditing issues. Assisted members of AICPA Accounting Standards Executive Committee and Auditing Standards Board in researching issues and drafting documents. Wrote policy manuals and training materials.

ADMINISTRATIVE MANAGER AND CONTROLLER (1968 - 1973) Products Engineering Corporation, Los Angeles. Corporate officer, who managed all administrative, financial, and accounting matters for manufacturing company. Negotiated government contracts, arranged financing, and managed personnel function and federally funded government training programs.

RESEARCH & PUBLICATIONS

COMMISSIONED RESEARCH PROJECT

Issues in the Perception of Auditor Independence: A Research Project Commissioned by the Chief Accountant of the United States Securities and Exchange Commission, SEC and Financial Reporting Institute, USC, 1985, 560 pages.

BOOKS

Rags to Riches General Ledger for Principles of Accounting, Houghton Mifflin Co., 1990.

Rags to Riches General Ledger for Financial Accounting, Houghton Mifflin Co., 1989.

MONOGRAPHS

"Three Issues in the Perceptions of Auditor Independence", Research Report No. 1, SEC and Financial Reporting Institute, USC, 1986.

Personnel Management, Human Capital Theory and Human Resource Accounting, Monograph Series: 27, Institute for Industrial Relations, UCLA, 1981, (with Eric Flamholtz).

PUBLISHED ARTICLES

"Organization of and Testing Procedures for Large Section Classes",
Proceedings of CSULB College of Business Administration Symposium
on Collegiate School of Business Teaching, (February 9, 1996), with Kathleen Lacey.

"Accounting by Borrowers for Participating Mortgages: A Historical Cost Paradox", Journal of Accountancy, July, 1992, (with Clifford Schwartz).

"Auditor/Client Joint Investments and Auditor Independence", Research in Accounting Regulation, 1990.

"The Impact of Auditor/Client Joint Investments on the Perception of Auditor Independence," Issues in Business Responsibility, Depaul University School of Business, 1988.

"Convergence of Accounting Ph.D. Programs", Doctoral Programs in Accounting, The Ohio State University, 1984.

"Determinates of the Corporate Decision to Capitalize Interest", Journal of Accounting and Economics, Vol. 3, 1981, pps. 151-179 (with Robert Bowen and Eric Noreen).

"The Implications of the Economic Theory of Human Capital for Personnel Management", Personnel Review, 10,1 1981, pps. 30- 40, (with Eric Flamholtz).

"Replacement Cost Accounting: Another Answer", CPA Journal, March 1976, pps. 13-19 (Cover feature).

"The Inter-American Accountant - Present and Future", Proceedings of the XI Inter-American Accounting Conference, AICPA, 1974 (with Morton Jaffe).

Book Review - Accounting Review - 1986.

PRESENTATIONS

Federal Judicial Center & National Judicial College, Presentations to Judges for the AICPA, 1996, 1997, 1998, 1999, 2000, 2001.
Texas Center for the Judiciary, Presentation to Judges for the AICPA, 1995, 1996, 1997, 1998, 1999.
Financial Accounting Standards Board, Board Meeting, 1995, 1996, 1997.
AICPA, Accounting Standards Executive Committee, 1989, 1990, 1991, 1992, 1993, 1994, 1995, 1996.
AICPA Annual Real Estate Conference, Accounting Standards Update, 1998.
AICPA Annual Real Estate Conference, Real Estate Revenue Recognition, 1999.
AICPA Annual Real Estate Conference, Alternative Practice Structures, 1999.
AICPA Annual Real Estate Conference, Real Estate Asset Impairment, 2000.
AICPA Annual Real Estate Conference, Interest Capitalization, 2000.
California Society of CPAs, International Accounting & Auditing Standards Update, 1997, 1998.
California Society of CPAs, Accounting Standards Update, 1995.
Governmental Investing, California State University, Long Beach, 1995.
California State University Instructional Computing Council, CSUN, 1996.
Western Regional American Accounting Association Conference, 1994.
40th Accounting Conference, Executive Enterprises, Washington, D.C., 1994.
39th Accounting Conference, Executive Enterprises, Washington, D.C., 1993.
Real Estate Accounting Conference, (Chair), Executive Enterprises, San Diego, 1993.
Southeastern Regional American Accounting Association Conference, 1990.
Midatlantic Regional American Accounting Association Conference, 1990.
DePaul University Research Conference, 1988.
Claremont McKenna College, Economics Department, 1988.
American Accounting Association Western Regional Meeting 1987.
USC Accounting Research Forum, 1982, 1983, 1984, 1985, 1986.
USC Finance Department Workshop, 1986.
American Accounting Association Annual Meeting 1983, 1985.
United States Securities & Exchange Commission, Chief Accountant and Staff, 1985.
Invited Participant at Journal of Accounting Research Empirical Conference, 1984.
University of Washington, Research Seminar, 1984.
USC Finance Department Events Study Conference, 1984.
AICPA, Private Companies Practice Section, 1984.
UCLA, Accounting Research Colloquium, 1982.

PROFESSIONAL TEACHING EXPERIENCE

The Capital Group
Los Angeles Society of Financial Analysts - Update on new Accounting Standards
Los Angeles Society of Financial Analysts - CFA Review Instructor Levels I & II
Los Angeles Society of Financial Analysts - Accounting Review
Union Bank Senior Loan Officer Program
Union Bank Junior Loan Officer Program
Wells Fargo Bank Loan Officers
US Department of Justice, Tax Division
Sidley & Austin
Pillsbury Madison & Sutro
Analysis Group
Association of Russian Petroleum Executives
Committee of Chinese Agricultural Accountants
Putnam Lovell
Price Waterhouse, Accounting for Lawyers
O'Melveny & Meyers
National Association of Television Production Executives
Carnation Company Management Controls
Carnation Company CMA Review Program
Los Angeles Times CMA Review Program
AICPA Continuing Professional Education
California CPA Society
CPE Associates
UCLA Advanced Management Program
UCLA CPA Review Program
USC CPA Review Program
USC CMA Review Program
USC Center for Telecommunications Management
USC Professional Management Program
USC Continuing Management Education
USC Management Policy Institute
USC Nigerian Executive Program

CONSULTING

The Irvine Company
Tidelands Oil Company
Anadarko Petroleum Corporation
Times Mirror Company
Carnation Company
Los Angeles Times
Sueba Corporation
Mason West
Baja Tours
Dave Bean Engineering
Pacifica Foundation
Oliver Wilson Productions
Jim Miller & Associates
Comedy & Magic Club
Comedy & Magic Club Productions

HONORS AND AWARDS

PROFESSOR OF THE MONTH, American Marketing Association, CSULB chapter, 1997.
CALIFORNIA SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS FACULTY MERIT AWARD, 1992.
RESEARCH FELLOW, California State University, Long Beach.
AD HOC REVIEWER, Accounting Review.
REVIEWER, Various American Accounting Associations Conferences.
REVIEWER, Accounting Horizons
USC ACCOUNTING CIRCLE FACULTY SCHOLAR, 1983,1985.
PRESIDENT AND FOUNDER, DOCTORAL STUDENTS ASSOCIATION, UCLA Graduate School of Management, 1979-80.
FELLOWSHIP, UCLA, 1979.
DOCTORAL BOARD, UCLA, 1978.
TEACHING AWARD, UCLA, 1978.
CALIFORNIA STATE FELLOWSHIP, Stanford, 1975.
HORNBY FELLOWSHIP, USC, 1972.
ACCOUNTING DEPARTMENT FELLOWSHIP, USC, 1972.

UNIVERSITY SERVICE

Faculty Liaison, Board of Advisors, College of Business - CSULB
College of Business Personnel Committee - CSULB
Faculty Development Center Advisory Board - CSULB
Executive MBA Committee - CSULB
MBA Admissions - CSULB
Department of Accounting Executive Committee - CSULB
Department of Accounting Curriculum Committee - CSULB
Chair, Department of Accounting Personnel Committee - CSULB
Faculty Development Center Committee - CSULB
MBA Core Faculty (4 years) - USC
Accounting Ph.D. Committee (3 years) - USC
Accounting Circle Committee (4 years, fundraising group) - USC
Active Accounting Research Forum participant - USC

AFFILIATIONS

American Institute of Certified Public Accountants
California Society of Certified Public Accountants
American Accounting Association
Association for Investment, Management, & Research
Los Angeles Society of Financial Analysts

COMMUNITY SERVICE

FINANCIAL CONSULTANT - (1997 - Present) Rolling Hills Community Association.

BOARD MEMBER AND TREASURER - (1989-1991) Palo Verde Seacliff Homeowners Association.

BOARD MEMBER - (1984 - 1989) UCLA Hospital Child Development Program.

BOARD MEMBER AND TREASURER - (1983 - 1985) Hermosa Beach Community Center Foundation.

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of Petition of WorldCom, Inc. Pursuant to Section 252(e)(5) of the Communications Act for Expedited Preemption of the Jurisdiction of the Virginia State Corporation Commission Regarding Interconnection Disputes with Verizon Virginia Inc., and for Expedited Arbitration	)	CC Docket No. 00-218
In the Matter of Petition of Cox Virginia Telecom, Inc., etc.	)	CC Docket No. 00-249
In the Matter of Petition of AT&T Communications of Virginia Inc., etc.	)	CC Docket No. 00-251

VERIZON VIRGINIA INC.

Testimony of Allen Sovereign

July 31, 2001

VERIZON VIRGINIA INC.

DIRECT TESTIMONY OF ALLEN E. SOVEREIGN

CC DOCKET NOS. 00-218, 00-249, 00-251

JULY 31, 2001

TABLE OF CONTENTS

I. INTRODUCTION
(JDPL Issues II-1-a; II-1-c; II-2-a; II-2-c)

Q. Please state your name, address and present background.

A. My name is Allen E. Sovereign. My business address is 600 Hidden Ridge, Irving, Texas 75038. I am employed by Verizon Consolidated Services Inc. as Group Manager-Capital Recovery.

Q. Please briefly describe your educational background.

A. I received a Bachelor of Science Degree in Electrical Engineering from Michigan Technological University, Houghton, Michigan, in 1971. I received a Master of Science Degree in Business Administration from Indiana University, Bloomington, Indiana, in 1980. I have attended courses in depreciation and life analysis provided by Depreciation Programs, Inc., of Kalamazoo, Michigan. I have also attended and instructed basic and advanced GTE courses in depreciation life analysis. I am a Senior Member of the Society of Depreciation Professionals.

Q. Please briefly describe your work experience with Verizon.

A. I have worked for Verizon (or one of its predecessor companies) for over 25 years, with 18 of those years in the depreciation study area. I have held various positions in Engineering and Construction, Capital Budgeting, Marketing, and Product Development. I was named to my current position in February 1994.

Q. What are the responsibilities of your current position?

A. I am responsible for the preparation, filing and resolution of capital recovery studies and the determination of economic lives for Verizon Consolidated Services Inc..

Q. Have you previously testified before any other regulatory bodies?

A. Yes, I have testified before state utility commissions in Arkansas, California, Hawaii, Florida, Idaho, Illinois, Indiana, Iowa, Kentucky, Maryland, Massachusetts, Michigan, Nebraska, Nevada, New Mexico, Ohio, Pennsylvania, South Carolina, Texas, Virginia, Washington, and Washington DC.

Q. What is the purpose of your direct testimony?

A. The purpose of this testimony is to recommend and support depreciation lives and future net salvages used in the cost studies to calculate unbundled network element ("UNE") rates for Verizon Virginia ("Verizon VA"). Drs. Kenneth Gordon and Howard Shelanski discuss in their direct testimony why my recommendations are consistent with economic theory. Dr. John Lacey explains that my recommendations are consistent with the Telecommunications Act of 1996 and TELRIC principles, and further explains that my recommendations conform to Generally Accepted Accounting Principles (GAAP). Mr. Harold West III discusses the state of competition in Virginia, and Dr. James Vander Weide

further discusses competition and risks Verizon VA faces in the provisioning of UNEs to CLECs.

Q. What depreciation inputs did Verizon VA use in the cost studies it submitted in this proceeding?

A. Verizon VA used the forward-looking economic lives and future net salvage values that it used in its 2000 financial reporting to its shareholders. Verizon VA revised some of the support accounts in 2001, but the lives for the major technology accounts remained unchanged. A complete list of the proposed depreciation lives and future net salvage percentages used in Verizon VA's cost studies is attached as Attachment A. The following lists several of the depreciation lives used in Verizon VA's cost studies.

Projection Lives (Years)

Account	Verizon Proposed
ESS Digital	10
Circuit Equipment	9
Aerial Cable Metallic	17
Underground Cable Metal	17
Buried Cable Metallic	17
Fiber Cable	20

Q. Please summarize your direct testimony.

A. This Commission should adopt the economic depreciation inputs Verizon VA used in its cost studies. Like the other costs Verizon VA proposes in this proceeding, Verizon VA's depreciation inputs are forward-looking. This forward-looking approach produces a more accurate estimate of assets' economic lives than an outdated historical approach.

When all local exchange companies were monopoly providers, regulators could defer capital recovery without affecting the ability of the regulated company to recover its investments. With the advent of local competition and with the continued rapid pace of technological change, however, regulators no longer have the luxury of postponing capital recovery in the rate-setting process. The changing telecommunications environment must be taken into consideration when determining the proper recovery period of an asset. The methodology described in my testimony considers these developments.

II. ECONOMIC LIVES ARE AFFECTED BY COMPETITION AND TECHNOLOGICAL INNOVATION. (JDPL Issues II-1-a; II-1-c; II-2-a; II-2-c)

Q. Please define the term "economic life" and how it relates to cost studies.

A. The economic life of an asset can be defined as the period of time over which an asset is used to provide economic value. Verizon VA's proposed depreciation inputs consider the decline in an asset's value from all causes, including competition and technological change. They reflect the principle that depreciation should be consistent with forward-looking economic assumptions and based on competitive market asset lives.

Q. What factors should this Commission consider in approving depreciation inputs for the cost model?

A. The two most important factors that must be considered in establishing the economic value of Verizon VA's assets are: (1) technological innovation and (2) the impact of competition. As explained more fully below, technological innovation and competition are flourishing in Virginia and will continue to increase in the foreseeable future. This is due not only to the opening of markets under the Telecommunications Act of 1996 ("Act"), but also to revolutionary technological developments that are occurring in Virginia.

The Commission must also consider the inherently risky nature of

providing UNEs. The provisioning of UNEs to CLECs poses risk for Verizon VA because CLECs are free to use UNEs while building their own networks, but then may abandon their use of Verizon VA UNEs after a short period of time.

Q. What technological innovations did you consider in determining Verizon VA's economic lives?

A. As Mr. Harold West III explains in his testimony and attached report, competitive carriers in Virginia are using a number of alternative technologies to provide telecommunications services – technologies that completely bypass the existing wireline network of the incumbent local exchange carrier ("ILEC"). These technologies include wireless local loops, cable television lines, and electric lines. For example, fixed wireless is already a viable alternative to traditional telephone service for many residential and business customers in Virginia and is expected to grow in popularity. The rate of growth of wireless subscribers in Virginia was 32% last year, higher than the national average of 27%.[1] In addition, both AT&T and Cox Communications offer voice service over their cable networks in Virginia. We have every reason to expect that such technology will continue to develop at an accelerated pace in Virginia.

[1] Robert Burke, *Wireless: The Next Stage*, Virginia Business, July 2001 at 35.

Q. What competitive developments did you consider in establishing Verizon VA's economic lives?

A. As discussed Mr. West's testimony, competitors in Virginia are increasingly providing service to customers by either reselling Verizon VA's service, purchasing Verizon VA's UNEs, or completely bypassing Verizon VA's network. The rapidly increasing rate of competition is a significant factor in determining the economic value of Verizon VA's assets.

In addition, companies such as AT&T and WorldCom are spending billions of dollars to bypass the ILECs' networks nationwide. AT&T currently serves approximately 150,000 cable subscribers in Virginia and is competing for local phone customers in the Richmond area through its cable company MediaOne. In addition, AT&T has publicly declared that it will offer local phone service via cable TV ("CATV") wires, either on its own[2] or in partnership with others, and via fixed wireless technology.[3] WorldCom is also investing in its own fixed wireless technology to bypass the LEC network and currently holds wireless licenses that cover 91 of Verizon VA's wire centers.

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[2] "AT&T Speeds Local Service Effort," Associated Press, January 8, 1999.

[3] *"Angel takes flight"* (May 18, 2000) <http://www.att.com/technology/features/0005fixedwireless.html>

Q. Please explain the impact of the CLECs' bypass strategies on depreciation lives.

A. The CLECs pursuing a bypass strategy are purchasing UNEs on an interim basis from Verizon VA. Verizon VA must therefore provide UNEs with no guarantee that the CLECs will continue to use these assets. Indeed, by providing facilities while CLECs construct their own networks, Verizon VA is essentially facilitating movement of customers off of its network. It follows, then, that the economic life of Verizon VA's facilities will be significantly shorter than in the past as competition continues to grow.

In short, if this Commission adopts unduly long depreciation lives, Verizon VA will therefore under-recover its forward-looking costs. Indeed, companies such as AT&T and WorldCom will thus have the best of both worlds – they will be able to obtain UNEs at prices substantially below their economic value, while completing their own networks to bypass the ILECs.

III. VERIZON VA APPROPRIATELY CONSIDERED ALL RELEVANT FACTORS IN DEVELOPING ITS PROPOSED ECONOMIC LIVES. (JDPL Issues II-1-a; II-1-c; II-2-a; II-2-c)

Q. Please explain how Verizon VA calculated its proposed economic lives.

A. To determine its proposed economic lives, Verizon VA considered (1) the retirement lives of assets as a guideline for estimating economic lives; (2) industry benchmark comparisons; and (c) the effects of evolving competitive markets.

Q. Please explain in more detail how you applied these factors.

A. Verizon VA first considered the National Association of Regulatory Utility Commissioners' ("NARUC") factors relating to the retirement of assets.[4] These include:

1. Physical Factors
   a. Wear and tear
   b. Decay or deterioration
   c. Action of the elements and accidents

[4] Public Utility Depreciation Practices, National Association of Regulatory Utility Commissioners (NARUC) at 15 (1996).

2. Functional Factors
   a. Inadequacy
   b. Obsolescence
   c. Changes in art and technology
   d. Changes in demand
   e. Requirements of public authorities
   f. Management discretion

3. Contingent Factors
   a. Casualties or disasters
   b. Extraordinary obsolescence

Verizon VA used these same factors to help estimate an asset's economic life expectancy by allocating the appropriate weighting to each factor to reflect the significant roles competition and technological change play in determining an asset's economic life. For example, the "Functional Factors" (Part 2 of the NARUC factors noted above) are sensitive to competition and technological change, and were therefore given substantially greater weight in establishing the economic lives of Verizon VA's assets.

Q. Explain how each of the functional factors were used in the determination of Verizon VA's economic lives.

A. Of all the factors considered, the functional factors "requirements of public authorities," "changes in art or technology," and "changes in demand" were given the greatest weight by Verizon VA.

Verizon VA must, for example, consider the possibility of future changes

in the requirements of public authorities when estimating the future economic value of its assets. Indeed, the FCC has ongoing rulemaking proceedings that aim to facilitate the development of fixed wireless service and to assist wireless providers in reaching customers.

Verizon VA must also consider how changes in technology during the relevant planning period will affect the economic value of its assets. As noted above, Verizon VA anticipates that the rate of technological development will continue to increase, as a number of emerging technologies will offer attractive alternatives to traditional telephone service.

Finally, Verizon VA must consider that demand for its network facilities will decrease as facilities-based competition and technological alternatives increase. In Virginia, for example, Cavalier Telephone offers service over its own network, which consists of 150 miles of fiber optic backbone, three Lucent 5EES switches, and more than 60 collocation sites. Cavalier's network is expected to expand, as it recently received $175 million in private funding to fund expansion and announced its intent to purchase Conectiv Communications in June, 2001.[5]

Q. How much weight was given to the functional factors?

A. For the technology-driven accounts — digital switching account, circuit equipment account, and cable — the functional factors were given virtually

[5] *See* Cavalier Telephone, *About Us*, <http://www.cavtel.com/about/about_main.htm>; G. Edwards, *Cavalier Telephone to Buy Conectiv Communications*, Richmond Times-Dispatch (June 7, 2001).

exclusive weight relative to the other factors listed above. Verizon VA took a more traditional approach for the determination of economic lives for the remaining accounts, which are less dependent on technological change. For example, in accounts such as motor vehicles or furniture, past patterns of retirement may be more useful in predicting future economic lives.

Q. Please explain how Verizon VA applied industry benchmarks in establishing economic lives.

A. In determining the appropriate economic lives, Verizon VA also considered competitive benchmarks, such as the depreciation lives of WorldCom, AT&T, and other cable television providers. Verizon VA also considered industry studies performed by Technology Futures Inc. ("TFI"). Benchmarking against our competitors permits Verizon VA to assess the reasonableness of its recommended depreciation lives.

Q. What conclusions did you draw when you compared AT&T's depreciation lives?

A. I concluded that Verizon VA's proposed lives are reasonable. AT&T's 1999 annual report states that the useful life ranges from 3 to 15 years for communications and network equipment; 3 to 7 years for other equipment; and 10

to 40 years for buildings and improvements. In fact, AT&T's lives are ***shorter*** than the lives proposed by Verizon VA in this proceeding. Specifically, I recommend 9 to 50 years for network equipment; 5 to 12 years for Other Equipment; and 30 years for buildings.

Q. Did you draw the same conclusions when you compared WorldCom's depreciation lives?

A. Yes. WorldCom's 1996 annual report stated that the weighted average depreciable life of the assets comprising the communications system in service is approximately 10 years. WorldCom's annual report further included a weighted average life of 6 years for furniture, fixtures and equipment, and 30 years for buildings. Verizon VA's recommendations, on the other hand, range from 9 to 50 years for equipment that comprises the communication system, 5 to 12 years for furniture, fixtures, and equipment, and 30 years for buildings.

In 1997, according to its annual report, WorldCom again shortened the weighted average depreciable life of the assets comprising its in-service communications system from approximately ten years to nine years.

Q. What conclusions did you reach when you compared the lives used by the cable television ("CATV") operators?

A. The lives used by CATV operators are ***shorter*** than Verizon VA's recommended lives. The useful lives adopted by this Commission for distribution facilities were from 10 to 15 years.[6] This range was developed from a statistical analysis of lives used by CATV operators for their own facilities. Verizon VA, on the other hand, has recommended a 17-year economic life for copper cable and a 20-year life for fiber cable, which are longer than the range allowed by this Commission for CATV distribution facilities.

Likewise, the lives proposed by Verizon VA for support assets such as office furniture and equipment, vehicles, and buildings are reasonable when compared to the ranges allowed by this Commission for CATV operators. This Commission's range is 9-11 years for office furniture and equipment and 3-7 years for vehicles and equipment, which compares favorably to Verizon VA's proposal of 5-12 years for these accounts. This Commission's range for buildings is 18-33 years, which compares favorably to Verizon VA's proposal of 30 years.[7]

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[6] *In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation and Adoption of a Uniform Accounting System for Provision of Regulated Cable Service*, MM Docket No. 93-215 and CS Docket No. 94-28, Second Report and Order, First Order on Reconsideration, and Further Notice of Proposed Rulemaking, FCC No. 95-502, 11 FCC Rcd. 2220, at 2258, 2314 (January 26, 1996).

[7] *See id.*

This type of "benchmarking," that is, comparing Verizon's lives to those of its competitors, has been used by various state commissions in establishing TELRIC rates. For example, the Missouri Public Service Commission compared Verizon's lives to the lives the largest IXC, CATV, cellular, CAP, and PCS providers and found that the depreciation for these companies were, in general, significantly shorter than Verizon's lives. The Missouri Commission concluded that "benchmarking GTE TELRIC rates against those booked for financial purposes of likely competitors and other companies using similar technologies is appropriate and is the best method to determine if GTE's TELRIC rates pass the muster of reasonableness."[8]

Q. Did you review other sources of information on depreciation lives?

A. Yes. As noted above, I considered TFI studies. TFI forecasts the remaining lives for certain assets due to technological changes. To quantify this technological change, TFI uses a model to analyze remaining economic lives using patterns of technological substitution observed in the communications industry and other industries. The industry studies conducted by TFI forecast the combined effects that competition and technological change will have on an asset's remaining useful life. The studies generally project shorter lives than traditionally prescribed by

[8] *In the Matter Of AT&T Communications of the Southwest Inc.'s Petition for Arbitration Pursuant to Section 252(b) of the Telecommunications Act of 1996 to Establish an Interconnection Agreement between AT&T Communications of the Southwest, Inc. and GTE Midwest Incorporated*, Case No. TO-97-63, Final Arbitration Order, Attachment C at 77 (Mo. P.S.C. July 31, 1997) ("Missouri Order").

most Commissions.

Q. What economic lives do the TFI studies recommend?

A. Verizon VA's recommendations here are in line with TFI's recommended economic life ranges, as shown by the following chart.[9]

A Comparison of the TFI Ranges with Verizon VA's Proposed Economic Lives

	TFI Ranges	Verizon Economic
Digital Switching Equipment	9-12	10
Circuit Equipment	6-9	9
Copper Cable	14-20	17
Fiber Cable	20	20

Q. Should traditional life estimation techniques be used to determine economic lives?

A. No. Traditional life estimation techniques are used to predict an asset's ***physical*** life, not its economic life. The physical life of an asset ends upon its retirement. Its economic life, however, is affected by competition and technological developments and may end even when there is no retirement of the asset.

For example, assume Verizon VA has a 1200 pair cable that it uses to provide service to 1000 customers. If Verizon VA must assume due to competition and technological change that 300 customers will leave, only 700

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[9] Larry K. Vanston, Ray L. Hodges, and Adrian J. Poitras, *Transforming the Local Exchange*

pairs of the original cable will be providing service to customers and economic value to Verizon VA in the future planning period. Thus, Verizon VA must assume that only 70% of the originally utilized investment will have economic value even though the assets still have physical life.

IV. REGULATORY PRESCRIBED LIVES SHOULD NOT BE USED IN FORWARD-LOOKING COST STUDIES. (JDPL Issues II-1-a; II-1-c; II-2-a; II-2-c)

Q. Why are your recommended economic lives shorter than past regulatory prescribed lives?

A. Historically, regulatory commissions prescribed asset lives assuming that there would be little or no competition and that technological innovation would continue at its traditional pace. These lives were used only for regulatory accounting purposes and bore little relationship to the real economic life of the asset. As discussed above, these assumptions are no longer valid given the rapidly increasing level of competition and technological alternatives in Virginia.

Q. Please explain in more detail why it is inappropriate to use regulatory prescribed lives in determining forward-looking costs.

A. As previously discussed, the economic life of an asset is the period of time over which that asset is used to provide economic value. Both increased competition

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Network: Analyses and Forecasts of Technology Change 33 (Technology Futures, Inc., 2d Ed. 1997).

and technological change shorten this period. When Verizon VA was the sole provider, depreciation rates were based upon artificially long asset lives. Because depreciation rates on long asset lives, the depreciation rates were lower, and the period of time over which the asset was depreciated was longer. These longer depreciation lives helped state commissions keep consumer prices artificially low while arguably still permitting Verizon VA to recover its investment.

Today's current market environment, however, reduces the length of time over which Verizon VA can recover its investment in an asset and invalidates the use of artificially long asset lives in calculating depreciation rates.

Q. When were the last regulatory prescribed lives determined?

A. The last regulatory prescribed lives were based on lives prescribed in 1994 and 1993, prior to the Act, and are sorely outdated. Because this proceeding requires forward-looking assumptions, using outdated regulatory prescribed depreciation inputs is inappropriate. The CLECs cannot have it both ways.

Q. Does the Virginia Commission currently analyze Verizon VA's depreciation lives?

A. No. The Virginia Commission determined, as part of its order approving an alternative regulation plan, that there is no compelling reason to continue the

rigorous review and approval process for Verizon VA's depreciation rates.[10] Since that decision, Verizon VA has used the same depreciation lives for intrastate regulatory reporting and for reporting purposes under the alternative regulation plan that it uses for financial reporting. These lives reflect Verizon VA's estimate of the effects of future technological developments and competition in Virginia. Verizon VA recommends that those same depreciation lives be approved for use in establishing UNE rates.

Q. Has any other regulatory body approved the use of economic lives for cost studies?

A. Yes. In 1996, the California Public Utilities Commission ("CPUC") endorsed use of the economic lives used by Verizon and Pacific Bell for external financial reporting in forward-looking cost studies. The CPUC rejected the CLECs' claim that that FCC-prescribed lives are forward-looking:

> We agree with Pacific that the schedules formally adopted in the represcription proceeding reflect the previous paradigm of the regulated monopoly environment, and so are difficult to justify in a cost study that looks forward to an environment in which there is local exchange competition. We also see little merit in the Coalition's original suggestion that we use FCC schedules. These schedules also reflect the previous paradigm; moreover, they are based on different assumptions and applied in different ways than our own. It also seems to be the case, however, that Pacific is now using these schedules in financial reports it is required to file, and thus for purposes of these cost studies, the schedules also appear consistent with generally accepted accounting principles. The schedules also appear realistic for a firm having to operate in a

[10] Case No. PUC930036, October 18, 1994, Section VI.

competitive environment, as Pacific will soon have to do. Accordingly, we will approve their use in this proceeding.[11]

Q. Has the Commission approved the use of financial reporting depreciation lives in other proceedings?

A. Yes. In its recent ruling in the SBC Kansas/Oklahoma 271 proceeding, the Commission found that SBC's use of financial reporting depreciation lives in developing UNE rates was reasonable:

> We reject AT&T's challenge to the depreciation rates. SWBT proposed setting depreciation rates based on the equipment lives that it uses for financial accounting purposes, and the ALJ made no explicit adjustments . . . . We accept the ALJ's conclusion on this matter. Our rules state that the depreciation rates must be economic. While it would be reasonable for a state to follow the depreciation rates the Commission has set for regulation of SWBT's interstate services, as Kansas and other states have done, other approaches are not necessarily unreasonable. We have never stated that states should be precluded from setting depreciation rates that differ from the Commission's, and do not do so here. A state may find that a depreciation schedule such as the one proposed by SWBT is appropriate, and AT&T has failed to indicate why it would not be so here.[12]

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[11] *Rulemaking on the Commission's Own Motion to Govern Open Access to Bottleneck Services and Establish a Framework for Network Architecture Development of Dominant Carrier Networks and Investigation on the Commission's Own Motion into Open Access and Network Architecture Development of Dominant Carrier Networks*, Rulemaking No. 93-04-003 and Investigation No. 93-04-002, Interim Opinion Adopting in Part and Ordering Modifications to Round I and II Cost Studies Submitted by Pacific Bell and GTE California, Decision No. 96-08-021 at 77 (Cal. P.U.C. August 2, 1996).

[12] Memorandum Opinion and Order, *In the Matter of Joint Application by SBC Communications Inc., et. al., For Provision of In-Region, InterLATA Services in Kansas and Oklahoma*, CC Docket No. 00-217, FCC 01-29, at ¶ 74 (January 22, 2001).

Q. Are Verizon VA's depreciation inputs reliable?

A. Yes, as Dr. John Lacey explains, these inputs are reliable because they are scrutinized by Verizon VA's external auditors and the financial community. Moreover, Verizon VA has no incentive to develop unreasonably (and unjustified) short depreciation lives because, although shorter lives may increase the cost of a UNE (other factors being equal), shorter lives negatively affect Verizon VA's earnings and the market's perception of Verizon VA.

V. CONCLUSION (JDPL Issues II-1-a; II-1-c; II-2-a; II-2-c)

Q. Please summarize your direct testimony.

A. Traditional historical methods of establishing depreciation lives are not forward-looking. The economic lives used in Verizon VA's cost studies, in contrast, are properly based on a forward-looking approach. Verizon VA proposes in this proceeding the same depreciation inputs used for financial reporting to shareholders. Verizon's proposed lives are reasonable in comparison to the financial reporting lives of competitive telecommunications providers such as AT&T and cable television companies.

Verizon VA's proposed depreciation inputs should be adopted for use in the UNE cost studies.

Q. Does this conclude your direct testimony?

A. Yes.

Declaration of Allen Sovereign

I declare under penalty of perjury that the foregoing is true and correct. Executed this 27th day of July, 2001.

Allen Sovereign

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Verizon Virginia Inc.
Recommended Depreciation Lives and Salvage Values

USOA ACCT	ACCOUNT DESCRIPTION	Verizon Lives Used in Current Cost Model LIFE YEARS	Verizon Lives Used in Current Cost Model SALVAGE %	2001 Verizon Lives Used for Financial Reporting LIFE YEARS	2001 Verizon Lives Used for Financial Reporting SALVAGE %
2112	Motor Vehicles	8	15	8	15
2116	Other Work Eq	10	0	12	0
2121	Buildings	30	2	35	0
2122	Furniture	12	0	15	0
2123.1	Office Support Eq	10	0	10	0
2123.2	Company Communications Eq	8	0	8	0
2124	General Purpose Computers	5	3	5	0
2212	Digital Electronic Switching	10	2	10	2
2220	Operator Systems	10	0	10	0
2231	Radio Systems	5	-5	5	0
2232	Circuit Eq	9	1	9	2
2351	Public Telephone	8	0	8	0
2362	Other Terminal Eq	8	0	7	0
2411	Poles	30	-90	30	-75
2421.1	Aerial Cable Metallic	17	-10	17	-10
2421.2	Aerial Cable NonMetallic	20	-10	20	-10
2422.1	Underground Cable Metallic	17	-10	17	-10
2422.2	Underground Cable NonMetallic	20	-10	20	-10
2423.1	Buried Cable Metallic	17	-5	17	-5
2423.2	Buried Cable NonMetallic	20	-10	20	-5
2424.1	Submarine Cable Metallic	17	-5	15	-10
2424.2	Submarine Cable NonMetallic	17	-5	20	-10
2426.1	Intrabuilding Cable Metallic	17	-5	17	-15
2426.2	Intrabuilding Cable NonMetallic	20	-10	20	-10
2441	Conduit Systems	50	-10	50	-10

ATTACHMENT A